upreme Court, U.S.
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No. 10-

IN THE

Supreme Court of the United States

JAMES S. PHELPS,
as Trustee, etc.,

Petitioner,

v.

ORANGE COUNTY ASSESSMENT
APPEALS BOARD NO. 1, et. al.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE
COURT OF APPEAL OF THE STATE OF CALIFORNIA

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED FOR REVIEW

Whether California Revenue & Taxation Code Sections 60 and 61, subdivision (g), violate the Contract, Equal Protection and Due Process Clauses of the United States Constitution when they are applied, as done and endorsed in a published decision of the California Court of Appeal, to cause a reassessment of real property that was vested in remainder beneficiaries of an irrevocable trust prior to the enactment of those statutes and prior to the 1978 adoption of California's Proposition 13 which amended the California Constitution to an acquisition property tax scheme.

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CITATIONS OF OPINIONS AND ORDERS

The opinion of the Court of Appeal of the State of California, Fourth Appellate District, Division Three, certified for publication, is reported at *Phelps v. Orange County Assessment Appeals Bd. No. 1*, 187 Cal. App. 4th 653 (2010) and is set forth in the appendix hereto. (App. 1a-26a.) The Order of the Superior Court of the State of California, County of Orange, is not reported and is set forth in the appendix hereto. (App. 26a-29a.) The Decision and Findings of Fact of the Assessment Appeals Board No. 1 for the County of Orange is also in the appendix. (App. 30a-44a.)

The Order of the Supreme Court for the State of California denying Petitioner's timely filed petition for review in *Phelps v. Orange County Assessment Appeals Board No. 1*, was filed on December 1, 2010, and is set forth in the appendix hereto. (App. 45a.)

STATEMENT OF JURISDICTION

The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a). This petition for a writ of certiorari is timely filed. The order of the Supreme Court for the State of California denying review was filed on December 1, 2010.

28 U.S.C. § 2403(b) may apply and, accordingly, this petition has been served on the Attorney General for the State of California.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

CALIFORNIA CONSTITUTION ARTICLE 13A [TAX LIMITATION]

> SEC. 2. (a) The "full cash value" means the county assessor's valuation of real property as shown on the 1975-76 tax bill under "full cash value" or, thereafter, the appraised value of real property when purchased, newly constructed, or a change in ownership has occurred after the 1975 assessment. All real property not already assessed up to the 1975-76 full cash value may be reassessed to reflect that valuation.

California Revenue and Taxation Code Section 60:

> A "change in ownership" means a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest.

California Revenue and Taxation Code Section 61:

> Except as otherwise provided in Section 62, change in ownership, as defined in Section 60, includes, but is not limited to:
>
> * * *
>
> (g) Any vesting of the right to possession or enjoyment of a remainder or reversionary

> interest that occurs upon the termination of a life estate or other similar precedent property interest, except as provided in subdivision (d) of Section 62 and in Section 63.

STATEMENT OF THE CASE[1]

John Wilson Phelps created a trust under his 1945 will and died in 1947. Pursuant to the probate court's decree of distribution issued in 1950 (containing substantially identical trust terms as set forth in the will), the trust came into existence as an irrevocable testamentary trust (the "Phelps Trust" or "Trust").[2] Petitioner and John W. Phelps II are the current Co-Trustees of the Trust. The Phelps Trust provides that John Wilson Phelps' wife (who died in 1970) and three children were the initial income beneficiaries during their lives. Trust corpus is to be retained in trust during the combined lifetimes of John Wilson Phelps' wife, children, and grandchildren living at the time of his 1947 death. The Trust is to terminate on the death of the last survivor of these, at which time trust corpus will be distributed to John Wilson Phelps' then living issue on the principle of representation.

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1. The following factual statement is taken in substance from the Court of Appeal's "Factual and Procedural Background" statement in *Phelps v. Orange County Assessment Appeals Bd. No. 1*, 187 Cal.App.4th 653, 656-659 (2010).

2. The terms of the trust were later modified by the probate court in 1983. (The term, "Phelps Trust" or "Trust" refers to these 1950 and 1983 orders specifying the terms of the testamentary trust.)

On April 16, 2002, John Wilson Phelps' son, Wilson W. Phelps ("Wilson"), died. Before his death, Wilson was an income beneficiary as to one-third of the trust income. Pursuant to the trust instrument, his four children (John Wilson Phelps' grandchildren) then became the current beneficiaries as to his one-third income interest, divided equally among them (each child received one-twelfth interest in the trust income).

Among the Phelps Trust's income producing assets at the time of Wilson's death were two parcels of real property in Fullerton, California, used as a shopping center (the "Fullerton Property"). Respondent/Real Party in Interest Webster J. Guillory, Assessor of Orange County (the "Assessor"), determined that a change in ownership under Revenue & Taxation Code section 60 ("Section 60") as to one-third of the Trust's Fullerton Property occurred when Wilson died in 2002. Accordingly, the Assessor reassessed at the current "full cash value" that one-third interest.

The Phelps Trust filed an application with the County of Orange Assessment Appeals Board No. 1 challenging the reassessment. The Board upheld the Assessor's position as to the Fullerton Property. (App. at 30a-44a.)

The Phelps Trust then filed a verified petition for writ of mandate in the Superior Court to set aside the Board's findings. In that petition, the Phelps Trust asserted, "as a matter of law, a change of ownership did not occur upon the death of Wilson W. Phelps and, consequently, those assessments were illegal and void." (1 Clerk's Transcript at 16.) The Superior Court denied the petition, concluding there was a reassessable change in ownership under

Section 60 in 2002, entitling the Assessor to reassess one-third of the Fullerton Property. (App. At 27a-29a.) The trial court entered judgment, and the Phelps Trust appealed to the California Court of Appeal, Fourth Appellate District, Division Three.

The California Court of Appeal affirmed, holding there was a change in ownership in 2002, when Wilson died and his interest in income as to one-third of the Fullerton Property passed to his children. Thus, the court held that property was reassessable under Section 60.

The Phelps Trust then filed a petition for review with the California Supreme Court. That court granted review but put the case on "hold" pending its forthcoming decision in *Steinhart v. County of Los Angeles*, 47 Cal.4th 1298 (2010). After the *Steinhart* decision was issued, the California Supreme Court vacated the *Phelps* appellate decision and remanded back to the California Court of Appeal, Fourth Appellate District, Division Three to reconsider in light of the *Steinhart* decision.

In supplemental briefing, the Phelps Trust asserted that the recent *Steinhart v. County of Los Angeles* decision confirms that the only "change of ownership" occurred in 1947 when John Wilson Phelps died. (Phelps Trust Supplemental Brief [filed in Court of Appeal on June 10, 2010] at 19; *see also* App. at 21a.) The Phelps Trust pointed out, however, that neither Proposition 13 nor Section 60 was effective in 1947. *Id.* In a published opinion, the California Court of Appeal affirmed its earlier holding. It found that, although there was a change in ownership in 1947, there was also a reassessable change in ownership as to one-third of the Fullerton Property when Wilson

died in 2002. (App. at 22a.) A petition for rehearing was filed by the Phelps Trust, which was denied by the Court of Appeal.

The Phelps Trust then filed a timely Petition for Review with the California Supreme Court. That Petition for Review included a four-page argument with the heading "Reassessment Triggers for Trusts Have Evolved to an Unfair System of Taxation Which Violates Trust Taxpayers' Equal Protection Rights." (Phelps Trust Petition for Review [filed in Supreme Court on September 27, 2010] at 25-29.) In that petition, the Phelps Trust explained the inconsistent triggers for reassessment "violate trust beneficiaries' equal protection rights under the Fourteenth Amendment of the Federal Constitution (U.S. Const., amend. XIV, § 1) and California Constitution, Article 1, Section 7, subdivision (a)." (*Id.* at 28.) The Petition for Review was denied on December 1, 2010. (App. at 45a.)

REASONS FOR ALLOWANCE OF THE PETITION

In their 1978 primary election, California voters adopted Proposition 13 to amend California's Constitution with Article XIIIA which limits both the amount of property tax which may be levied and when property may be subject to reassessment. Specifically, the California Constitution now states, among other things, that a "change in ownership" of property subjects that property to reassessment at "full cash value." Cal. Const. art. XIIIA, §2, subd. (a). The effective date for this constitutional provision was July 1, 1979 (Cal. Const. art. XIIIA, §5), and the "full cash value" was defined as the county assessor's valuation as shown on the 1975-76

tax bill or thereafter the appraised value when a change in ownership has occurred (Cal. Const. art. XIIIA, §2, subd. (a)).

The California Legislature later enacted Revenue & Taxation Code section 60 ("Section 60") to define the constitutional term, "change in ownership," along with Revenue & Taxation Code section 61 ("Section 61") to give illustrative examples of how the Section 60 definition applied in various situations.[3]

To the extent Section 60 and Section 61, subdivision (g), are applied, as the California Court of Appeal did here, to treat an irrevocable trust's remainder interest that vested pre-1978 as a "change in ownership" of trust real property, the statutes are unconstitutional. When trustor John Wilson Phelps died in 1947, he transferred property to the trustees of an irrevocable trust, the Phelps Trust. California law and common-law principles long recognized by this Court hold that the remainder and intermediate beneficiaries named in that Phelps Trust obtained property rights and interests that vested at that time. That the beneficiaries did not acquire a current interest in trust income in 1947 (and therefore, did not have possession and enjoyment of trust income) is not relevant to the question of whether their interests vested under trust and property law. The crucial point is that the beneficiaries' interests in the trust and their right to the trust income were vested.

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3. Both statutes added Stats. 1979 ch. 242 §4, effective July 10, 1979; Section 60 has not been amended since; subd. (g) of Section 61 was initially lettered subd. (f) but effective January 1, 1997, was changed to subd. (g) and otherwise that subdivision has not been amended since initial 1979 adoption.

The California Court of Appeal here held that, in 2002, when certain vested remainder beneficiaries under the John Wilson Phelps Trust came into possession of the trust income, this was a reassessable change in ownership under Sections 60 and 61, subdivision (g).[4] As discussed below, under Supreme Court authority, this is an unconstitutional taking of the trust beneficiaries' rights in violation of the Contract and Due Process clauses of the United States Constitution. The Constitution and law of this Court mandate that only taxation statutes in effect at the time of vesting of a property right (versus actual possession or enjoyment of property) can be applied to a purported transfer of property.

A. California Amends Its Constitution Pursuant to Proposition 13 to Define Taxable Property Transfers, After 1975.

Proposition 13, termed the "California Taxpayers' Revolt," amended California's Constitution to place restrictions on property taxes and reassessments. Section 2 of Article XIIIA of the California Constitution now restricts the assessed value of real property. Specifically, subparagraph (a) of Article XIIIA section 2, specifies that appraisal of property (i.e., reassessment) at its "full cash value" may only occur "when purchased, newly constructed, or a change in ownership has occurred after the 1975 assessment." Cal. Const. Art. XIIIA, § 2, subd. (a).

The terms "purchased" and "newly constructed" are defined in the constitutional amendment. However,

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4. No beneficiary has a current right to trust principal until he trust terminates.

"[b]ecause Proposition 13 did not explicate the meaning of 'change in ownership' [citations], it fell to the Legislature to define the phrase . . .. The main effort to create consistent and uniform guidelines to implement Proposition 13's undefined 'change in ownership' provision was undertaken by a 35-member panel . . .." *Pacific Southwest Realty Company v. County of Los Angeles*, 1 Cal.4th 155, 161 (1991). This panel, known as the "Task Force," recommended a definition of a "change in ownership" that was adopted verbatim by the California Legislature as California Revenue and Taxation Code Section 60 ("Section 60"). *Id.*

Section 60 provides: "A 'change in ownership' means a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest." Thus, the current law in California states that any transfer of property that meets the elements of Section 60 is reassessable.

Furthermore, subdivision (g) of Section 61 provides that a "change in ownership" as defined in Section 60 includes the "vesting of the right to possession or enjoyment of a remainder or reversionary interest that occurs upon the termination of a life estate or other similar precedent property interest . . .."

B. The Federal Constitution Requires That Property Transfers Are Subject Only to the Tax Law in Effect at the Time the Property Right Vests.

In *Coolidge v. Long*, 282 U.S. 582 (1931), trustees petitioned this Court for a writ, claiming a Massachusetts inheritance tax statute was "repugnant to the contract clause of the Federal Constitution and the due process and

equal protection clauses of the Fourteenth Amendment." *Id.* at 593. The tax statute at issue in *Coolidge* became law after the declaration of the Coolidge irrevocable trust was executed. *Id.* at 595.[5] The issue was whether that inheritance tax statute was unconstitutional when applied to transfers of property rights that had "so vested prior to the taking effect of that tax statute that there was thereafter no occasion in respect of which the excise might constitutionally be imposed." *Id.* at 597.

In the case, Mr. & Mrs. Coolidge created an irrevocable trust which gave them a life estate in a property's income and divided the property's remainder interest among their five sons. This Court found that each son's one-fifth remainder interest was "immediately vested" in each of them at the moment of the execution of the irrevocable deed of trust. *Id.* at 597 (citations omitted.) Payment of income to the parents for their lives "did not operate to postpone the vesting in their sons of the right of possession or enjoyment." *Id.* Further, the sons' right to possession stemmed from the deed of trust and was not "derived" from or subject to transmission from the parents upon their death. *Id.* at 598. That the property was subject to divesture if a son died before the last survivor of their parents, this Court found irrelevant. After analyzing

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5. This was the second of two cases this Court heard concerning the Coolidge Trust. In the first case, this Court held that the federal revenue act violated the Fifth Amendment "insofar as it undertook to impose a tax on gifts fully consummated before its provisions came before Congress or before its passage." *Id.* at 595-96 (citations omitted). This Court noted the transfer of the property by decedent was prior to the passage of the Act and it was irrelevant "the conveyance was intended to take effect in possession or enjoyment at or after his death." *Id.* at 596.

consistent law from several jurisdictions, this Court found the sons' right to the property interest vested on the creation of Coolidge's irrevocable deed of trust. *Id.*[6]

Next, this Court assessed whether applying a tax statute that did not exist when the sons' right to that property had vested under the terms of the trust was unconstitutional. This Court confirmed that trust deeds are contracts protected under the Contract Clause of the federal Constitution. *Id.* at 595. Accordingly, states are prevented by this clause from enacting any subsequent legislation "to take or destroy rights which had vested under them." *Id.*.

Citing authority from the California Supreme Court, this Court explained: "It is the vesting in interest that constitutes the succession, and the question of liability to such tax must be determined by the law in force at that time." *Id.* at 604, *citing Hunt v. Wicht*, 174 Cal. 205, 209 (1917). This Court went on to cite with approval law from several states with the same rule. *Id.; e.g.* "[W]here there was a complete vesting of a residuary estate before the enactment of the transfer tax statute, it cannot be reached by that form of taxation." *Id.* at 603, citing *In Matter of Pell*, 171 N.Y. 48, 55 (1902). This Court reasoned that, if property rights are vested prior to enactment of a tax act, there is "in no legal sense a transfer of the property at the time of possession and enjoyment." *Id.* at 603.

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6. The result would be different, as this Court recognized, for other types of trust instruments, such as a revocable trust or a trust that contained a power of appointment. *Id.* at 598-599, 602. Similarly, a will that is probated is treated differently. *Id.* at 600-601.

Accordingly, this Court in *Coolidge* noted: "This court has not sustained any state law imposing an excise upon mere entry into possession and enjoyment of property, where the right to such possession and enjoyment upon the happening if a specified event had fully vested before the enactment." *Id.* at 600. The Court concluded that the vesting in *Coolidge* was complete when the irrevocable trust deeds of the Coolidge parents were executed. This Court explained a tax based on a later-enacted law would "diminish the value of these vested estates, to impair the obligation of a contract, and take private property for public use without compensation." *Id.* Accordingly, this Court held the state statute was unconstitutional because enforcing an excise tax that was enacted at a later time "would be repugnant to the contract clause of the Constitution and the due process clause of the Fourteenth Amendment." *Id.* at 605-606.

C. The Phelps' Trust Beneficiaries Property Rights Vested in 1947.

Where the jurisdiction of this Court is invoked to determine whether a state law is unconstitutional and the question turns on the terms of a contract, this Court determines for itself the contract's meaning and effect. *Coolidge*, 282 U.S. at 597. When John Wilson Phelps died in 1947, his will became irrevocable and the Phelps Trust was established as an irrevocable testamentary trust pursuant to the probate court's decree of distribution. As discussed, *supra*, this Court held "the overwhelming weight of authority" is that the transfer of property in such a situation occurs when an irrevocable trust deed takes effect and the beneficiaries are vested with their rights to property. *Id.* at 602. As also explained by this Court

in *Coolidge*, there is "in no legal sense a transfer of the property at the time of [later] possession and enjoyment." *Id.* at 603. Applying this law to the Phelps Trust, the transfer of the trust property occurred in 1947 when the trust became irrevocable and all beneficiaries' rights in trust property necessarily vested.

This same result is mandated by California law. In a recent decision, the California Supreme Court in *Steinhart v. County of Los Angeles*, 47 Cal. 4th 1298 held, when the trustor dies and the trust becomes irrevocable, all property interests are transferred and vested in all the trust beneficiaries collectively. *Id.* at 1320, 1324. Thus, in 1947, when John Wilson Phelps died and the Phelps Trust became irrevocable, all interests (possessory or remainder) were transferred and vested at that time. Specifically, the Phelps Trust granted vested and possessory life estate interests to John Wilson Phelps' surviving spouse and their three children (one of which was Wilson). At that same time, the terms of the Trust granted vested and future remainder interests to the issue of their children (i.e. their grandchildren then living). Accordingly, Wilson's children (John Wilson Phelps' grandchildren then living) had a vested property right in the Phelps Trust in 1947.

Steinhart and the law analyzed and approved by this Court in *Coolidge* confirm there was no new transfer by Wilson in 2002 to John Wilson Phelps' grandchildren. This is because the entire equitable interest in the trust property was transferred when the Trust became irrevocable in 1947. Although Wilson's children had a future interest that became possessory in 2002, the property rights to that interest were transferred to them from John Wilson Phelps in 1947 and were vested then.

Simply, John Wilson Phelps was the transferor in 1947 and not Wilson in 2002. Under the rule of *Steinhart* and the authority discussed and relied on by this Court in *Coolidge*, it is irrelevant whether some of those interests in the Phelps Trust property were immediate possessory life estates and others were future remainder interests.

In sum, when Wilson died in 2002, the previously vested interests of his children merely became possessory. But, as in *Coolidge*, this is not a transfer of property in 2002; it is just possession of a property right previously vested in 1947.

D. Certiorari Should Be Granted Because the California Court of Appeal's Interpretation of Reassessable Property Transfers Under Proposition 13 Is Unconstitutional.

Here, the California Court of Appeal, in a published decision, held that when Wilson died in 2002 and John Wilson Phelps' grandchildren came into possession of their share of one-third life interest income per the terms of the Phelps Trust, this triggered a tax reassessment under Section 60. However, as analyzed by this Court in *Coolidge* and the California Supreme Court in *Steinhart*, John Wilson Phelps' grandchildren's rights in that property were vested in 1947 when the Phelps Trust was executed and became irrevocable. John Wilson Phelps conveyed the entire equitable interest in trust property to all the collective trust beneficiaries, including those grandchildren, when the Phelps Trust became irrevocable at his death in 1947. As explained in *Coolidge*, there can be no new transfer in 2002 as to the beneficial interests that were already granted and vested in 1947 merely because those interests became possessory in 2002.

The rule set forth in *Coolidge* is that only the law in force at the time of the vesting of property rights can constitutionally apply to tax a transfer. Applying a law not extant at the time of vesting, merely because beneficiaries come in to actual possession and enjoyment of property at a later date (or, as with the Phelps Trust, possession of an interest in income), is a violation of the Contract and Due Process clauses of the federal Constitution. By its decision, the California Court of Appeal makes California's rule of reassessment on a "change in ownership" after the 1975 assessment (Cal. Const. art. XIIIA, §2, subd. (a)) unconstitutionally reach back and apply retroactively to a 1947 transfer of property.[7]

In sum, it was unconstitutional for the California Court of Appeal to hold that John Wilson Phelps' grandchildren's right to possess a property right in 2002 that was previously vested in 1947 was a new transfer and a new

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7. Although the tax statute at issue here in *Phelps* is not a *per se* tax on succession like the tax in *Coolidge*, the effect here and on the myriad other similarly situated cases is the same. California's Proposition 13 changed the property tax system in California to an acquisition system. *See Amador Valley Joint Union H.S. District v. State Board of Equalization*, 22 Cal.3d 208 (1978). Reassessment may now occur only when ownership changes. In California, when a trustor dies and the trust becomes irrevocable, as recognized in *Steinhart v. County of Los Angeles*, 47 Cal.4th 1298, there is a change in ownership of whatever real property is in that trust as to all trust beneficiaries collectively, present and remainder. In other words, for the Phelps Trust and similar situations involving testamentary and irrevocable inter vivos instruments, ownership changes by succession when a trustor dies and the trust is irrevocable. This triggers the negative tax consequence of reassessment. Thus, California's acquisition system of real property taxation, as it is applied to estates and trusts under current law, has the same effect as a tax on succession.

change in ownership subject to a tax reassessment in 2002 under Section 60. This is an unconstitutional application of Section 60 and Section 61 because these statutes, with their negative tax consequence of reassessment, did not exist when all the property interests—including those of John Wilson Phelps' grandchildren—vested in 1947. As explained in *Coolidge*, applying these current statutes to a 1947 vesting of property rights violates the Contract and Due Process clauses of the Constitution. Because every property interest in California under a trust that was executed and became irrevocable before 1975 is now subject to this same unconstitutional application of Sections 60 and 61, this Court should grant a writ of certiorari to resolve this important constitutional issue.

CONCLUSION

For all these reasons explained above, this Court should grant a writ of certiorari.

Respectfully submitted,

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